

**FAIR POLITICAL PRACTICES COMMISSION**  
**Memorandum**

**To:** Chairman Randolph, Commissioners Blair, Downey, Huguenin, and Remy

**From:** John W. Wallace, Assistant General Counsel  
Luisa Menchaca, General Counsel

**Subject:** Proposed:

- Adoption of Regulation 18750.2: Procedures for the Promulgation and Adoption of Conflict of Interest Codes for State Agencies Exempt from the Administrative Procedures Act.
- Adoption of Regulation 18755: Statements of Economic Interests: Person or Persons at an Institution of Higher Education with Principal Responsibility for a Research Project; and Amendment to Regulation 18702.4: Exceptions.

**Date:** April 29, 2005

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**I. Executive Summary**

*Proposed Adoption of Regulation 18750.2: Procedures for the Promulgation and Adoption of Conflict of Interest Codes for State Agencies Exempt from the Administrative Procedures Act:* State and local agencies are required by the Political Reform Act to adopt conflict of interest codes. These codes designate employee positions that are required to file Statements of Economic Interest and assigns disclosure categories specifying the types of interests to be reported. State agencies adopt these codes pursuant to the Administrative Procedures Act (the APA) and the Commission reviews them as the code reviewing body.

However, certain state agencies, such as the University of California and the Legislature are not subject to the APA. Due to this fact, over the years, Commission staff and these agencies have developed hybrid procedures for enacting codes and code amendments. Staff is asking the Commission to adopt regulation 18750.2 to codify a procedure for agencies that are not subject to the APA.

*Adoption of Regulation 18755: Statements of Economic Interests: Person or Persons at an Institution of Higher Education with Principal Responsibility for a Research Project; and Amendment to Regulation 18702.4: Exceptions.* In the past, the Commission adopted a specialized regulation for educational decisions made by public officials. That regulation provides that disclosure and disqualification is not required for teaching decision and certain research decisions. (See Regulation 18704.2 at **Appendix I**.) Consistent with this regulation, researchers with principal responsibility for a project (referred to as “principal investigators” or “PIs”) have had specialized disclosure and disqualification rules. However, the procedures

for applying these rules have never been specifically set forth in a regulation. Proposed regulation 18755 would set forth the filing requirements for PIs. In addition, the proposed regulation codifies for the first time a list of nonprofits that need not be disclosed under these rules.

## **II. Promulgation of Conflict of Interest Codes for Non-APA Agencies**

### **A. Background**

The conflict-of-interest provisions of the Act prohibit public officials from making, participating in making, or attempting to use their official position to influence a governmental decision in which they know or have reason to know they have a financial interest. (Section 87100.) The prohibition ensures that public officials perform their duties free from bias caused by their financial interests or the financial interests of persons who have supported them. (Section 81001(b).) To further this goal, the Act requires public officials to report their economic interests each year on their SEI.

Designated employees must disclose only those economic interests that are described in their agency's conflict of interest code. (Sections 87300 - 87309.) A "designated employee" includes any officer, employee, or consultant of any agency whose position with the agency is exempt from the state civil service system or is designated in a conflict of interest code because the position entails the making or participation in the making of decisions which may foreseeably have a material effect on any financial interest. (Section 82019.)

Section 87302 describes the substantive provisions an agency must include in its code.

*1. Terms of the Code:* The terms of the code comprise the main body of a code and include such provisions as the manner in which to report financial interests, the disqualification procedures, etc. As noted above, the Commission recommends that agencies incorporate the standard code in regulation 18730 by reference because the type of information required to be in the main body of the code is quite complex. The Commission regularly amends regulation 18730 to include legislative and regulatory changes that affect the main body of the code; therefore, this component of an agency's code is automatically kept in compliance with the Act.

*2. Designated Positions:* The code must specifically list positions that make or participate in making decisions. Typically, positions that involve voting on matters, negotiating contracts, or making recommendations on purchases without substantive review must be included in codes.

*3. Disclosure Categories:* A primary purpose of the code is to require disclosure of those types of investments, interests in real property, sources of income and business positions that officials may affect in their decision-making.

Codes are not effective until they have been approved by an agency's code reviewing body (section 87303). The code reviewing body for city agencies is the city council. The code reviewing body for an agency wholly within a county is the county board of supervisors. The code reviewing body for multi-county and state agencies (other than agencies in the judicial branch of government) is the Commission.

Section 87311 provides the process by which codes for state agencies, under the Commission's purview as code reviewing body, are developed and adopted:

“The review of proposed Conflict of Interest Codes by the Commission and by the Attorney General and the preparation of proposed Conflict of Interest Codes by state agencies shall be subject to the Administrative Procedure Act. The review and preparation of Conflict of Interest Codes by local government agencies shall be carried out under procedures which guarantee to officers, employees, members, and consultants of the agency and to residents of the jurisdiction adequate notice and a fair opportunity to present their views.”

Regulation 18750(c) provides that an agency proposing a conflict of interest code or an amendment to an existing code must “(1) Conduct a public hearing or establish a written comment period. (2) Prepare an initial proposed code or an initial proposed amendment. (3) Prepare a notice of intention to adopt a conflict of interest code, or to amend an existing code.”

The regulation further provides that the agency must file a copy of the notice with the Office of Administrative Law for publication in the California Notice Register at least 60 days before the public hearing or close of the comment period; file a copy of the notice with the Commission at least 45 days before the public hearing or close of the written comment period; provide notice to the public, including notice to each employee of the agency affected by the proposed code or amendment at least 45 days before the hearing or the close of the comment period; make the exact terms of the proposed code or amendment available for inspection and copying to interested persons for at least 45 days prior to the public hearing or the close of the comment period; accept written comments; and conduct a public hearing on the proposed code or amendment if requested by an interested party.

However, certain state agencies subject to the Commission's code reviewing authority, such as the UC and the Legislature, are not subject to the APA. Due to this fact, over the years the Commission staff and these agencies have developed hybrid procedures for enacting codes and code amendments for these agencies, outside the parameters of regulation 18750.<sup>1</sup> For example, the UC Board of Regents notices proposed amendments to its conflict of interest code through the Wall Street Journal, the Los Angeles Times and the San Francisco

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<sup>1</sup> Section 87309 provides that no Conflict of Interest Code or amendment shall be approved by the code reviewing body or upheld by a court if it: (a) Fails to provide reasonable assurance that all foreseeable potential conflict of interest situations will be disclosed or prevented; (b) Fails to provide to each affected person a clear and specific statement of his duties under the Code; or (c) Fails to adequately differentiate between designated employees with different powers and responsibilities.

Chronicle. In addition, the UC Regents also notify by letter each individual holding a newly proposed designated position. This process has been in place since as early as 1977. In contrast, the Legislature notices proposed amendments to its conflict of interest code on the official website. Staff is asking the Commission to codify a procedure for agencies not subject to the APA.

At the February Commission meeting the Commission directed staff to notice regulation 18750.2 for adoption. The Commission determined that the proposed regulation should require that agencies covered by the regulation advertise the proposed code on the home page of their agency websites. On March 9, 2005, Commission staff held an interested persons' meeting. The general response from interested persons was support of the proposals. Further discussions with the University of California resulted in staff's proposal to delete subdivisions (c)(3)(J) and (K) which were the embodiment of two APA requirements that do not apply to the agencies in question.

Finally, based on discussions with the Judicial Council of California, Administrative Office of the Courts, we have added clarifying language to subdivision (a) to reflect the limited scope of the regulation to agencies that are: (1) under the Commission's authority as code reviewing body (this does not include agencies in the judicial branch of government), and (2) exempt from the requirement in Government Code section 11346.4(a)(5) of the Administrative Procedures Act that requires publication of the proposed conflict of interest code in the California Regulatory Notice Register.

## **B. Discussion of Proposed Regulatory Action**

The staff proposal mirrors the language and process of regulation 18750 (Procedures for the Promulgation and Adoption of Conflict of Interest Codes for State Agencies) and inserts it into new regulation 18750.2 (Procedures for the Promulgation and Adoption of Conflict of Interest Codes for State Agencies Exempt from the Administrative Procedures Act). Regulation 18750.2 differs from 18750 only in a few respects.

1. Staff has added clarifying language to subdivision (a) to reflect the limited scope of the regulation to agencies that are: (1) under the Commission's authority as code reviewing body (this does not include agencies in the judicial branch of government),<sup>2</sup> and (2) exempt from the requirement in Government Code section 11346.4(a)(5) of the Administrative Procedures Act which requires publication of the proposed conflict of interest code in the California Regulatory Notice Register.

2. Staff has removed subdivisions (c)(3)(J) and (K) from the draft regulation. These sections were the embodiment of two APA requirements that do not apply to the agencies in question.

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<sup>2</sup> Note that regulation 18750 will also be amended to expressly reflect the scope of the regulation, consistent with the requirements of section 82011 which defines "Code Reviewing Body." This amendment will be a part of the technical packet scheduled for September.

3. Instead of the notice required by the APA, the proposed regulation would require that proposed amendments to conflict of interest codes for these agencies be posted on the home page of the agency website. (Regulation 18750.2 (c)(4).)

*Staff Recommendation:* Staff recommends the Commission adopt proposed regulation 18750.2.

### **III. List of Exempt Organizations**

#### **A. Background**

Prior to 1981, the disqualification and disclosure requirements of the Act applied only to university administrators with “institution or campus-wide administrative responsibilities.” (Regulation 18702.4(c)(1)(B).) In 1981, in response to a case involving use of UC research for the personal benefit of a PI, the Commission added a requirement that PIs disclose economic interests if a research project was to be funded by a nongovernmental entity.

As noted above, regulation 18702.4(c)(2) now provides:

“Disclosure shall be required under Government Code section 87302 or any Conflict of Interest Code in connection with a decision made by a person or persons at an institution of higher education with principal responsibility for a research project to undertake such research, if it is to be funded or supported, in whole or in part, by a contract or grant (or other funds earmarked by the donor for a specific research project or for a specific researcher) from a nongovernmental entity, but disqualification may not be required under Government Code sections 87100, 87302 or any Conflict of Interest Code in connection with any such decision if the decision is substantively reviewed by an independent committee established within the institution.”

Thus, under the Act, disclosure and disqualification is not required with respect to decisions made by persons who have research responsibilities at the University of California concerning the allocation of financial and material resources for academic research, and all decisions relating to the manner or methodology with which the research will be conducted. This regulation effectively places these types of decision-makers outside the disclosure provisions of the Act except under the circumstances discussed below.

*Disqualification:* Unlike other public officials, PIs may accept research funding from private sponsors and continue to make governmental decisions even though they have a disqualifying conflict of interest under section 87100. This could be the case where the PI has an interest in a sponsor of the research, but the independent review committee substantively reviews and approves the funding because the project furthers the mission of the university. Under the proposal, disqualification is still not required in connection with any such decision if the decision is substantively reviewed by an independent committee established within the institution.

*Disclosure:* The existing system is set forth in the university policy on disclosure of financial interest in private sponsors of research (April 26, 1984) which is posted on the UC's website.

- Each PI fills out the form 700U when notified that a nongovernmental entity intends to award a gift or research grant. PIs disclose economic interests in the sponsor of research which is funded in whole or in part: (a) through a contract or grant with a nongovernmental entity, or (b) by a gift from a nongovernmental entity which is earmarked by the donor for a specific PI.
- Disclosure statements must be filed: (a) before final acceptance of such a contract, grant, or gift; (b) when funding is renewed; and (c) within 90 days after expiration in the case of a contract or grant, or after funds have been completely expended in the case of a gift.
- PIs disclose income from and ownership interest in the sponsor, as well as positions held with the sponsor.

Both the Commission and the UC have agreed to a list of certain sponsors that do not pose a significant threat of a conflict of interest based on their size and national reputation in the field. This list has been maintained by the UC. The UC approaches the Commission when it wishes to modify the listing. Entities are added based on the following criteria:

- A. Whether the nonprofit organization has been in existence for an extended period of time.
- B. Whether the nonprofit organization does not receive major funding from, nor is it tied to, a corporate source.
- C. Whether the nonprofit organization has a national reputation.
- D. Whether the nonprofit organization serves, or funds research in, a broad geographic area.

If the researcher has no financial relationship to the sponsor, then the disclosure statement is labeled "negative." A statement is "positive" where there is a financial interest. An independent campus committee reviews "positive" statements for conflicts of interest. Independent campus review committees are made up of faculty and, at some campuses, student or public members. The committees review all positive statements pertaining to applications to do research which are funded by private monies. The review is based on the following guidelines:

- Is a traditional conflict-of-interest situation avoided?
- Is the research appropriate for the university?
- Are teaching and research environments open?

- Are publication and dissemination of research results unrestricted?
- Is it in the best interests of the university that the private sponsor has exclusive licensing rights?
- Is use of university facilities and resources appropriate?

The UC also uses a streamlined process under certain circumstances. This process requires only abbreviated documentary justification when there is a:

- Renewal of funding with no change or a reduction in the researcher's financial involvement and no material change in the terms under which the research is being conducted.
- Completion statements with no change or a reduction in the researcher's financial involvement.
- Offer of private funding and the PI's involvement is limited to:
  - (a) Membership on a scientific advisory board.
  - (b) Income between \$250 and \$1,000 and the income is not derived from consulting related to the project being funded.
  - (c) An investment between \$1,000 and \$10,000 in a publicly-traded stock.

At the February Commission meeting the Commission directed staff to notice regulation 18755 for adoption. On March 9, 2005, Commission staff held an interested persons' meeting concerning this packet of regulations. Again, the interested persons were supportive, especially the UC. However, the UC did suggest a series of revisions to the language to clarify the current standards and current rules. The UC also renewed its request to eliminate the final filing for principal investigators, as discussed in more detail below.

## **B. Discussion of Proposed Regulatory Action**

Staff proposes two regulatory changes.

*Amend Regulation 18702.4:* Regulation 18702.4 is amended simply to cross reference new regulation 18755, which provides greater specificity to the disclosure obligations of PIs. Since regulation 18702.4 is primarily a disqualification provision, staff has opted to place the disclosure rules in a new regulation, regulation 18755.

*Adopt New Regulation 18755 -- SEIs: Person or Persons at an Institution of Higher Education with Principal Responsibility for a Research Project*

The proposed regulation has gone through numerous changes since the February Commission meeting. Most of the proposed changes were suggested by the UC to clarify the current system and were not intended to be substantive. Subdivision (a) still describes when filing of an SEI may be triggered. It provides:

“(a) Disclosure shall be required under Government Code section 87302 or any conflict of interest code in connection with a decision made by a person or persons at an institution of higher education with principal responsibility for a research project to undertake such research, if it is to be funded or supported, in whole or in part by:

“(1) A contract or grant from a nongovernmental entity sponsor, or

“(2) Other funds from a nongovernmental entity earmarked by the donor for a specific research project or for a specific researcher.”

**Decision point 1:** Subdivision (b) describes types of filings, including “initial” filings, “interim,” and “final” filings. This system of filing was originally intended to mirror the filings required of other designated employees who must file an assuming office, annual, and leaving office statement.

However, at the March 9 IP meeting, the UC again raised the issue of the relevancy of the final filings. As the UC representative explained, the principal investigator filings are unique in that they are centered on a single discrete decision. Regulation 18704.2(c)(2) provides that disclosure is only required “in connection with a decision made by a person or persons at an institution of higher education with principal responsibility for a research project *to undertake such research* [emphasis added].” Subdivision (c)(1)(B) provides that neither disclosure nor disqualification applies to decisions to pursue a course of academic study or research, to apply for funds to finance such a project, to allocate financial and material resources for such academic study or research, and all decisions relating to the manner or methodology with which such study or research will be conducted. Thus, the UC argues that since the only purpose for disclosure is to regulate the decision *to undertake such research*, the filing of the final statement serves no relationship to that purpose.

An argument can be made, however, that while the final report does not reflect holdings of the PI at the time the initial decision to undertake the research is made, it does prevent circumvention of the rule by simply delaying acquisition of the interest to after the completion of the research.

After further consideration of the UC’s position, and the countervailing arguments, both Technical Assistance and the Legal Division agree that the final filing should be eliminated. Consequently, the regulation has the final filing requirement bracketed to allow the Commission to delete this requirement should the Commission agree with staff and the UC.



Subdivision (c) describes the content of statements generally. This section has been rewritten to line up with the instructions for the completion of the 700U. These provisions are consistent with the current rules for disclosure that apply to the PIs.

Subdivision (d)(1) codifies the list of exempt private entities. Subdivision (d)(2) codifies the criteria that are applied for inclusion on the list of exempt entities. The section has been modified in order to clarify the standards. At the February Commission meeting, the question was raised as to whether it would be useful to have the list adopted as part of the regulation, or to keep it separate from the regulation to avoid the burden of regulatory procedure each time the list is amended. Staff's view is that the content, and ultimately the existence, of the list is the Commission's purview. Thus, incorporating the list in the regulation ensures rigorous review of these exempt agencies as well as alerting the public (both regulated and interested) of the actual scope of disclosure required under the regulation.

*Staff Recommendation:* Staff recommends the Commission adopt proposed regulation 18755 as modified and with the exclusion of subdivision (b)(3). Staff agrees that the final filing does not serve a significant purpose in connection with the decision to *undertake* research. And finally, with respect to inclusion of the list in the regulation, staff believes that inclusion in the regulation body will make amending the list a Commission decision, in contrast to a staff decision. This is consistent with our prior informal practice.

#### Appendix:

1. Proposed regulations 18702.4, 18750.2, and 18755